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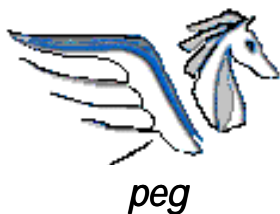
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Kemana Indonesia's Financial Sector?

By Lloyd R. Kenward



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Kemana Indonesia's Financial Sector?

Part I: The Banks

Indonesia's financial system comprises three distinctly different sub-sectors. The largest component, the banking system, is struggling in the wake of the 1997/98 financial crisis. It is the subject of this Report. The second sub-sector (capital markets, comprising equities and bonds) is the subject of a separate, accompanying Report (see "Part II: Capital Markets"), which should be read in conjunction with this Report. The third sub-sector covers a widely diverse group companies (notably, finance, pensions, insurance and cooperatives), and they are not covered by this study.

With this coverage in mind, this Report looks at the outlook and key issues in Indonesia's banking sector, with special attention to the options facing Indonesian policy-makers. It is organized in two sections, the first of which briefly reviews the key characteristics of Indonesia's banks (see immediately below). The second Section, B, looks ahead, at eleven pivotal issues facing Indonesian policy-makers in the banking sub-sector. For each issue, recommendations are provided as regards Bappenas' appropriate position. Three Appendices are also included, covering specific topics that came up in the course of this consultancy.

Section A: Key Features of Indonesia's Current Banking System

The 1997 financial crisis wrecked havoc on Indonesia's banking sector. The subsequent, extremely expensive recapitalization exercise stabilized the situation, and overall there has been encouraging progress. For example, 70 banks have been closed; 13 banks have been effectively nationalized; 10 banks merged (as of early 2002); the total number of licensed banks fell from 237 at mid-1997 to 145 by end-2001; and Rp 310 trillion of loans (book value) were transferred to IBRA. This is major consolidation. More recently, lending began to increase in early 2001 and credit has been growing at 25-35% per annum for more than a year now (see Chart 1). Also, commercial bank equity swung into positive territory in mid-2000; the intermediation spread (as measured by the SBI rate less the time deposit rate at 3-month tenors) turned positive around the same time; and interest rates (real rates for both loans and deposits) have been down to pre-crisis levels for some time.

However, major problems still remain. Most importantly, government bonds are now the commercial banks' largest asset (see Chart 2),¹ real interest rates remain high and this is extremely expensive for the fiscal accounts. As a counterpart to these

¹ Indeed, government bonds account for substantially more than half of the assets of several banks. For example (at end-2001): BII (64.6%); BCA (58.9%); Bank Mandiri (58.5%); Danamon (52.7%); and BTN (52.0%). For the 10 largest banks, recap bonds represent 52% of total assets. At the end of Q12002, Bank Indonesia reports that recap bonds were 53.2% of total productive assets at "systemically important" banks.

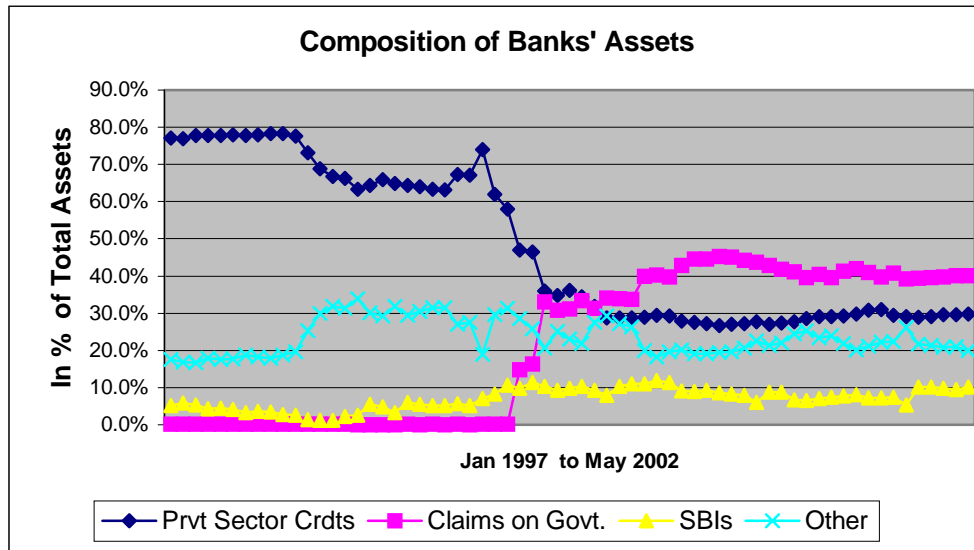
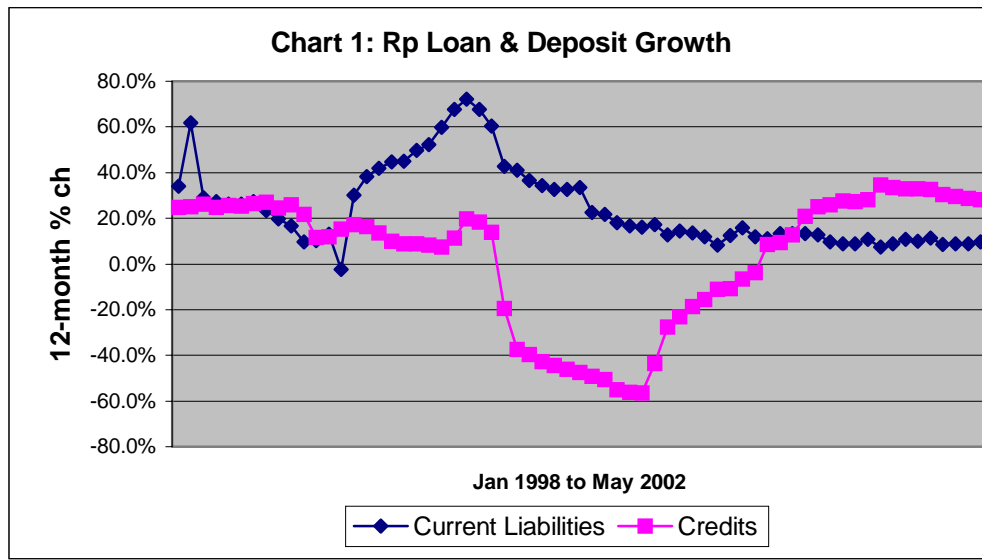
recapitalization bonds, the government now owns about 2/3rds of the commercial banking system. In addition and notwithstanding the strong growth in bank lending noted above, there has been virtually no change in the broad composition of bank assets during the past year (see Chart 2). Furthermore, several banks did not meet the 8% CAR requirement at end-2001 and several others appear at risk; BII has required a *third* round of recapitalization; classified assets remain high (about 12 ½%), despite a push by Bank Indonesia to get them down to 5% by end-2001; and many restructured loans throughout the banking system need further restructuring.

Moreover, there are limited prospects for a significant acceleration in economic growth, which could rescue the situation quickly. Indeed, there is concern that another economic slowdown could cause the banks to slip back into crisis. Finally, and perhaps most importantly, there is no national consensus on how to resolve these problems, including on the relatively straightforward issue of the return of recapitalized banks to the private sector. Overcoming these many problems will be a significant, long-term challenge for Indonesia.

A few other features of the current banking system are notable at the outset. First, Indonesia's banking system is dominated by a relatively small number of large commercial banks. For example, the largest (Bank Mandiri) accounts for more than ¼ of total assets, and the top 10 banks (out of a total of 145) account for 3/4s. Second, ownership is concentrated in the state. Of those top 10 banks, only 2 (Panin and Citibank) are fully privately owned. Also, only five foreign banks rank among the top 20. Third, a surprisingly large number of banks (23) are listed on the Jakarta Stock Exchange, but most are small- to mid-tier and trading in their shares is normally very thin. In addition to commercial banks, there are very large numbers of small rural credit banks (BPRs) and village credit institutions (BKDs), some 2,300 and 4,500, respectively.

Deposits, like the banks, are highly concentrated. At the lower end of the scale, more than 2/3rds of the *total number* of accounts are under Rp5 million, but these represent only 8% of the *total value* of accounts. By contrast, very large deposits (Rp 1 billion or more) represent less than 1/10th of 1% of the *total number* of deposits, but more than 36% of the *total value* of deposits.

Part I: The Banks



Section B: Forward-Looking Issues in the Banking System

Issue #1: No Consensus on Prescriptions

One of the main reasons for slow progress to date in economic recovery has been disagreement on how to overcome well-known weaknesses in Indonesia's financial system. Policy decisions come very slowly, even with strong international support; there is limited coordination among related agencies; delays in implementation are common; and slippages are frequent. Until there is something approaching a national consensus (among policy-makers, analysts and parliamentarians) on the need to accelerate progress, advances will continue to come slowly and policy reversals will be frequent. In the meantime, there is a significant risk that the sector could slip back into crisis.

Recommended Position for Bappenas: The Ministers and their senior staff need to strive for a consensus among themselves and with Parliament. Bappenas staff should pursue every opportunity (e.g., Repeta, Propenas, FSPC meetings and local seminars) for awareness-raising and consensus-building among parliamentarians, the public and their counterparts in other agencies. Consensus would be particularly useful in the following areas (which are discussed in more detail in the remainder of this Report):

- A vision for the structure of the Indonesian financial system, say, a decade hence.
- The appropriate balance between central bank independence and accountability.
- The role of recapitalization bonds in the preservation of financial stability.
- The importance of sales of assets in reducing the outstanding stock of recapitalization bonds. And,
- The appropriate institutional arrangements for financial sector supervision, including deposit insurance.

Issue #2: BI's Isolationism

One element of Indonesia's program with the IMF was intended to give Bank Indonesia (BI) independence from political influence. Instead, the central bank has become isolated from other institutions in Jakarta, and the institution seems troubled by legalist issues and by weaknesses in the managerial appointment process. These problems are magnified by resentments among other local institutions towards what they regard as BI's lack of accountability.

This situation has been a barrier to coordination of macroeconomic policies; it slows progress in key areas of economic reform (e.g., consolidated financial sector supervision, resolution of the BLBI issue and development of a Treasury Bill market); and it fosters turf disputes that further damage Indonesia's external image. Furthermore, no resolution to these problems is on the horizon.

Recommended Position for Bappenas: BI needs to re-engage in macroeconomic policy discussions with the rest of government. Bappenas should look for opportunities to act as a bridge between Bank Indonesia and other government agencies.

Issue #3: Outlook for Recap Bonds

Stabilization of the 1997/98 crisis in the banking sector required that the government issue some Rp 430 trillion in ‘recapitalization’ bonds.² The interest cost for the budget is very high³ and some interest payments (on the so-called ‘hedge’ bonds) are effectively denominated in foreign currency. Another Rp 218 trillion in bonds were issued to Bank Indonesia in settlement of the cost of liquidity support (BLBI) for banks during the depth of the crisis.⁴

There are several important issues concerning these bonds. First, the interest cost is a heavy, on-going burden on the budget, which puts a premium on lower inflation, financial stability, improved financial intermediation and resultant lower interest rates. Second, resolution of the BLBI issue between the government and Bank Indonesia has been difficult.⁵ Third, many analysts believe that the government was overly generous in issuing bonds to the banks, as evidenced by very high CARs at some banks and surprisingly good profitability.⁶ Fourth and most importantly, large amounts of bonds mature beginning in 2004 and there are serious issues as to whether the government will have the cash to redeem these bonds at maturity. This final issue is discussed in more detail immediately below.

The maturity structure of the recap bonds is shown in Chart 3. This presentation excludes the hedge bonds (which have provision for an automatic rollover) and the BLBI, which are assumed to be eventually resolved without the need for cash. As described in Part II of this Report, the 2003 maturities are larger than the current existing rupiah bond market, and the maturities jump almost fivefold, beginning in 2004.

The recap bonds are a major source of revenue for many banks and a key to financial stability. Without interest revenue from this source, several large banks would not be able to pay interest on their deposits. If banks fail to pay interest on the deposits, there would be runs on the banks, provoking another crisis. Likewise, if the government

² An additional moderate amount of recapitalization, of the order of Rp 20 trillion, was financed by so-called ‘recycle bonds’ that is, bonds that had already been returned to the government (IBRA).

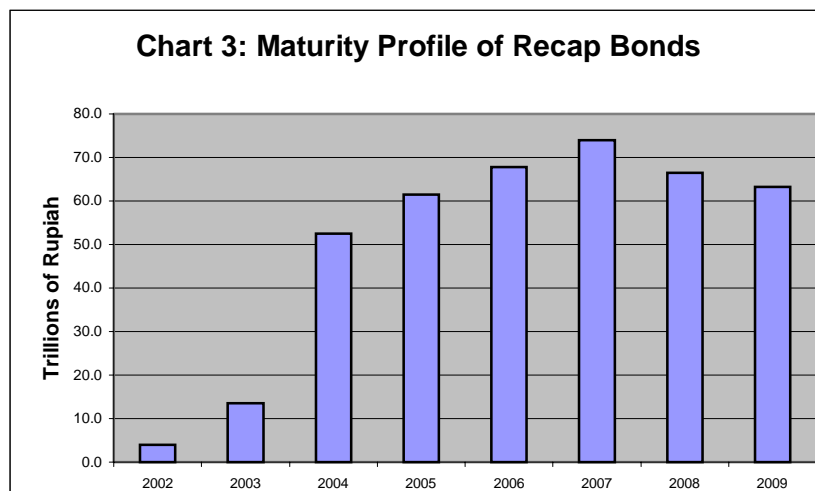
³ In addition to the large stock of debt, interest rates are also high. They vary from 10-16 1/2% on fixed rate bonds; variable rate bonds currently pay 15%, the 3-month SBI rate.

⁴ Accrued interest (at 3% plus inflation) has raised the outstanding amount to some Rp 270 trillion by mid-2002. The exact amounts are in dispute.

⁵ Resolution may be at hand (see Appendix III), by the exchange of BLBI for government perpetuities that only bear interest in the unlikely event that Bank Indonesia’s capital is impaired.

⁶ For instance, Bank Mandiri recorded a net profit of US\$274 million (at an exchange rate of Rp 10,000/US\$) in 2001, representing a 25.5% rate of return on equity. BCA’s profits and return on equity were US\$312 million and 31.9%, respectively. Bank Danamon’s and BNI’s were US\$72 million and 17.3%, and US\$176 million and 25.8%, respectively.

does not have the cash to redeem the bonds when they mature, the market value of the bonds would fall significantly, impairing the solvency of the banks.



Recommended Position for Bappenas: It ought to be a matter of priority for the government to reduce the burden and vulnerability that arise from its high levels of indebtedness. At present, debt is falling sharply in relation to GDP; if this trajectory can be maintained for the next few years, Indonesia has very good prospects of not slipping into a debt trap.

In this regard, several steps need to be taken, more or less simultaneously, to ensure that the government has the requisite cash when the recap bonds mature.

1. Significantly improve the local bond market (see Part B in the accompanying Report, Issue #1);
2. Begin the issuance of Treasury Bills,⁷ which could provide several trillions of short-term financing for the government;⁸
3. Prepare to re-finance maturing bonds by market-based issuance of new, long-term (10-year or more) bonds;⁹

⁷ There are sub-issues associated with this step. For example, its legal basis (the Sovereign Debt Law) is currently stalled in Parliament. Also, current plans calls for the issuance of only 6- and 12-month T-Bills initially, significantly reducing the average maturity of government debt. This exposes the government to 'rollover risk' (that is, the government might not be able to rollover large amounts of debt every few months), which raises the likelihood that the government will default in the event of another financial crisis.

⁸ It is envisaged that T-Bills would eventually replace SBIs as the instrument for monetary control. As of mid-2002, very roughly Rp 100 trillion in SBIs were outstanding, but the great bulk are at 1-month maturity. Consequently, the appetite for 6- and 12-month T-bills would initially be fairly limited, especially if interest rates stabilize.

⁹ With Telekom bonds (which currently carry interest rates of 17%) as a benchmark, market-based placements of government bonds would probably entail interest rates near 17%, rising significantly as larger amounts of government bonds are placed. These increases could be reduced by significant

4. Use proceeds from the sale of IBRA assets (and privatizations) to redeem and pre-pay outstanding bonds;
5. Keep borrowing by the regional governments under control, including by refusal by the central government to guarantee loans to the region. Ultimately, some defaults by the regions may be needed to establish the center's credibility in this regard.
6. Raise domestic revenues by 2 or more percentage points of GDP by 2004, using as much of the additional revenues as possible to redeem maturing bonds; and,
7. Prepare a contingency plan as a safeguard in the event that the government does not have enough cash to redeem all maturing issues in 2004 or beyond. This contingency plan should include consideration and decisions on the following:
 - Rescheduling the repayment of principal on recap bonds, preferably on an equivalent net present value basis.
 - Limited swaps of zero-coupon bonds for recap bonds at some banks (see Appendix III).
 - Which recap bonds should be swapped and rescheduled? Only those in banks' investment portfolios seem advisable.
 - Which banks' bonds should be rescheduled? The four state banks are the obvious candidates, but BNI, which is 99% state-owned, might be more complicated.
 - The implications for the timing of privatization of banks? For example, Bank Mandiri's IPO should not go ahead until its bonds are rescheduled. And,
 - The advisability of forced rollovers in the event that agreement cannot be reached on the above topics.

Issue #4: Outlook for Lending

As mentioned, bank lending is presently expanding at about 30% *per annum*. This is encouraging, and it seems likely to continue for the next several months at least, because lending is picking up from such a small base at some large banks. Indeed, it could even accelerate for a short while because, according to market players, many winners at IBRA's asset sale of July 2002 will likely finance their purchases using fresh local borrowing.

'Prime' lending rates seem stuck at 18-19%, despite recent drops in SBI and deposit rates. Bankers correctly note that corporate bonds (the main private sector alternative to bank financing) are also priced in the 18-19% range. But there is also an issue of competitiveness within the banking sector, given that state ownership dominates the banking system. Of the 7 largest banks in the system (representing 2/3rds of all bank assets), 6 are almost wholly owned by government; the only exception is BCA, which has only recently been partially divested.

improvements in the secondary market for bonds and by lower inflation. Still, it seems unlikely that rates could be brought down to current SBI rates, that is, 15%. Consequently, market-based re-financing of all maturing issues would probably be very expensive for the government.

By sector, strong lending is largely originating in consumer and SME lending (with the latter currently accounting for 43% of new bank loans, according to Bank Indonesia). Corporate lending continues weak, apart from some consumer-related sectors. Banks note a paucity of quality lending opportunities to corporates; even good companies have become tainted, if they are part of a troubled Group.¹⁰ As IBRA sales wind down and corporate restructuring proceeds, lending to companies will likely pick up somewhat, but no strong rebound should be expected until GDP growth accelerates and factories' capacity utilization rates rise appreciably.

Recommended Position for Bappenas: Banks need to restore their financial intermediation function, by substituting loans for government bonds on the assets side of their balance sheets. The purchase of loans from IBRA (BPPN) is one short-term option in this regard (see Appendix III, including for other options), and it appears that several recap banks bid successfully on IBRA's July sale of assets.¹¹ Another possibility is the use of moral suasion by the authorities—particularly vis-à-vis state-owned banks, including the recap banks—to nudge lending rates down, in line with deposit and SBI rates. However, ultimately only strong, sustained overall economic growth is going to cause lending to grow fast enough to restore balance sheets to 'normal'.

Issue #5: Outlook for Numbers of Banks and the Rest of Their Balance Sheets

As regards numbers of banks, more consolidation is in store for the Indonesian banking sector. As mentioned, market players believe that many banks barely meet the minimum CAR requirement and that their capital structures are vulnerable to exchange rate depreciation, interest rate increases or deterioration in quality of assets. Bank Indonesia has officially acknowledged this problem without specific reference to numbers of banks. In addition, the phase-out of the deposit guarantee could provoke a flight-to-quality that will force more mergers or closures. Alternatively, the phase-out of the deposit guarantee may cause some banks to raise their deposit rates to compensate depositors for risk; for particularly risky banks, this could impair those banks' profitability.

On the side of deposits, there is a strong likelihood that deposits will drop in relation to GDP during the next few years. Two factors will be driving this. First, phased elimination of the government guarantee will reduce the attractiveness of large bank deposits, beginning in early August 2003. And second, as the market for government bonds expands (and Treasury Bills are introduced), there will be attractive options to short-term bank deposits. Both factors will push large, institutional depositors (like pension funds and insurance companies) out of deposits and into long-term assets (which would match their long term liabilities).

¹⁰ This is spillover from the concept of 'One Obligor' in corporate restructuring, which was intended to increase the leverage of IBRA in its negotiations with indebted Groups.

¹¹ The benefits should not be overstated. Banks like Mandiri and BCA have probably won only a few trillion rupiah of IBRA's loans. This amount is very small in comparison with Mandiri's and BCA's holdings of roughly Rp 150 and 50 trillion in recap bonds, respectively.

The Indonesian banking system has re-entered offshore debt markets. In December 2001, Bank Mandiri launched US\$125 million in floating rate notes (with a B-rating by Standard & Poor's)¹² on the Hong Kong Stock Exchange. This marked the first international capital market transaction by an Indonesian state-owned enterprise since the crisis of 1997. As follow-up, in early August Bank Mandiri placed a US\$125 million subordinated debt issue,¹³ listed in Singapore.¹⁴

Turning to the quality of assets and banks, Bank Indonesia set end-2001 targets of 5% and 8% for non-performing loans (NPLs) and CARs respectively, with the stated intention of raising the quality of Indonesia's banking system to international standards (see Appendix I). This was a noble objective. However, the choice of targets was very arbitrary; achieving them would not have raised Indonesia's banks to international standards;¹⁵ and the targets were too ambitious. Consequently, by early 2002 the NPL ratio for the national banking system was 12.4%, well above the 5% target; less than half of all banks had NPLs below 5%; and 'several' still had NPLs above 35%.¹⁶ Having failed to achieve the targets, BI simply extended its deadline by one year, to end-2002. Still, it seems unlikely that the new target will be achieved, which will further erode BI's credibility as a prudential regulator.

With regard to CARs, Bank Indonesia reports that 137 banks (out of a total of 145) reached the 8% target by end-2001, which implies that 8 banks were in violation. During 1Q 2002, 6 national private banks were put under 'special surveillance'; 4 are planning to undertake a merger; and 2 have committed to adding additional capital. BI also acknowledges that 'several' other banks' CARs are only a little above 8%, whereas market participants estimate that 25 banks or more may fall into this category.

Recommended Position for Bappenas: More bank consolidation is in store, and their deposit base is likely to shrink especially if the government adopts market-based re-financing of maturing bonds (see Issue #3). In addition, BI should stop setting unachievable targets. It would be much better to set achievable targets and impose sanctions on offending banks (for example, close down banks that don't meet minimum CAR requirements and force banks to write-off uncollectable loans).

¹² Curiously, this is two grades higher than the sovereign rating of the Republic of Indonesia.

¹³ This is an aggressive borrowing as subordinated debt is unusual in Indonesia (see Appendix II). The proceeds may be used to rollover maturing debt.

¹⁴ The maturity is 10 years (with a 5-year call option); with a coupon rate of 10.625% for the first 5 years (and 11.20% for years 6-10); it was priced at 747bps over 5-year US Treasuries, which is expensive. The issue was over-subscribed by almost 50%, with about two-thirds of the orders from outside Indonesia.

¹⁵ Indonesia is well behind international standards. For instance, Bank Indonesia's annual report for 2001 states that the latest review of compliance with the 25 Basel Core Principles, indicates that Indonesia is fully compliant with only 2 principles; it is largely compliant with 5 others. Discussions with BI staff indicate that the situation may have improved somewhat during 2002 to date.

¹⁶ Some familiar names are among the worst offenders. For example, BII (estimated at 60%); Deutsche Bank and HSBC (both around 45%); ABN-AMRO (just over 30%); and BNI (20%).

Issue #6: Consolidated Financial Sector Supervision (OJK)

This concept was originally championed by one of the international financial institutions (IFIs) and the Ministry of Finance strongly supports the initiative. There is currently some variation among the other IFIs in their support for the idea, and Bank Indonesia is clearly resisting, partly in defense of its turf. As of mid-2002, the concept had advanced to the point where a draft Law is almost complete, and it is expected to go to Parliament in September.

Some aspects of the draft Law are notable. First, it provides for a 1-year transition from the existing structure of supervision. Second, it provides for a powerful institution, with considerable accountability and independence, reporting directly to the President, who chooses the Board of Directors and CEO (perhaps with the approval of parliament). Third, the Board has control of budget and staffing, financed by a 4 bp fee on assets of supervised institutions. Initially the staff is expected to come from Bank Indonesia, Bapepam and MoF (DGFI) through an open appointment system, which would also consider candidates from other institutions. Salaries are expected to be comparable to BI's.

Despite the advanced stage of this legislation, there still appear to be some important outstanding issues. For example, will OJK set policy or will it simply implement policy? If OJK does not make policy, which institutions will set policy and how will these be coordinated? Also, responsibilities during the transitional year are not entirely clear. By way of example, if a banking sector crisis were to break during the transition year, who accepts responsibility, BI or OJK? Further in this regard, there may also be legal issues, if BI's authority expires at end-2002, but OJK is not operational for another 12 months.

There are likely to be delays and serious problems in implementing the OJK. First, there will be a great deal of political maneuvering to get control of this new, powerful institution, essentially to serve narrow commercial interests. Second, unless the requisite legislation is passed by parliament quickly (i.e., in late 2002), the appointments of management and staff of OJK will take place during the run-up to the 2004 election, which will entail further politicization and delays. Third, there will be continuing institutional turf disputes and issues of staffing, until this issue is finally put to rest. Finally, there will be a host of organizational,¹⁷ legal and technical issues to be addressed, hopefully without the loss of existing continuity in supervision.

Recommended Position for Bappenas: Consolidated financial supervision is a worthwhile objective. In addition, Bank Indonesia has a poor track record of bank supervision, which justifies its responsibility being turned over to a new powerful agency, managed and staffed by strong professionals of high integrity. However, for OJK to be successful in an Indonesian context, three conditions must be satisfied: i) independence

¹⁷ As envisaged, OJK would initially be organized along lines that mirror the existing systems of supervision. For example, one department in OJK would be responsible for banking supervision, another department for capital market supervision, another for insurance companies, etc. Integration of the departments would take place at a later date.

from political influence; ii) technical competence of its staff; iii) and strong institutional relationships with related financial institutions (e.g., Bank Indonesia, the Ministry of Finance, IBRA and the Deposit Insurance Institution). As of mid-2002, all of these looked unlikely.

Issue #7: Deposit Insurance and the Government Guarantee

The government has recently announced its plans for phasing out the government (blanket) guarantee of bank liabilities. The timing of the announcement was excellent (just when the rupiah was appreciating markedly); the schedule of the phase-out seems practical; and the sequencing is reasonable.¹⁸

Regarding phase-out, coverage of most debt liabilities would end in February 2003; coverage of inter-bank liabilities and very large deposits would end in August 2003; and coverage of medium- to large-deposits would end in February 2004. Coverage would continue for deposits up to Rp 100 million (roughly US\$11,500 at current exchange rates). This amount is relatively high, roughly 15 times per capita income. It would cover about 98% of all depositors but less than 40% of the total value of deposits.

Two other points may be made concerning this proposal. First, some L/Cs are already uncovered by the guarantee and it's odd that these were not mentioned in the proposal. And second, the uneven distribution of deposits implies that well over half of deposits will not be covered by the guarantee. Consequently, a more gradual lowering of the deposit ceiling might be envisaged.

The deposit insurance initiative is less advanced. Coordinating staff at Bank Indonesia are aware of the key issues, and they have views on preferred policy choices.¹⁹ However, as of July 2002, no official proposals have been announced, apart from the ceiling (of Rp 100,000 million) that was part of the proposal to remove the government guarantee. Probably, a new institution will be created to administer the deposit insurance scheme; implementation will go ahead on a path parallel to the removal of the deposit guarantee (see above); the new institution will become a 'cash-box' operation for financing bank closures; and premiums will be charged at the flat rate of 0.25% of insured deposits.

In viewing inter-action between Deposit Insurance and the Government Guarantee, several issues still seem to be outstanding. For example, what is the analytical basis for the premium of .25% and to what extent does it reflect the risk of bank closures when the guarantee is lifted? Likewise, what are the costs and benefits of deposit insurance for the BPRs? There are also important issues concerning management of the insurance fund, for instance: how to ensure the independence and professionalism

¹⁸ It's odd that the guarantee on inter-bank lending is not lifted sooner. Banks are among the best placed to assess the riskiness of other banks.

¹⁹ For instance, fixed versus risk-based premiums (staff prefer fixed for reasons of simplicity); mandatory versus voluntary (staff prefer mandatory); and financing arrangements in the event of cash-box shortfalls (staff prefer public to private sources).

of the fund manager; what are the portfolio restrictions on the insurance reserves (e.g., abroad, real estate, government bonds, etc.); and the implications for monetary control of funds' disbursement in the event of a bank failure.

It's important not be naïve on several issues in this regard. First, the government guarantee is not costing much at the moment, because there's little systemic risk in the system at present.²⁰ Second, the current banking system is so opaque that it's impossible for depositors to determine which banks are 'safe'. Consequently, actual removal of the guarantee may trigger flight of large, private deposits especially from the smaller banks, forcing more consolidation. Third, it will be some time before a deposit insurance fund can accumulate enough reserves to finance the closure of many banks.²¹ Fourth, any banking crisis during the interim period will probably entail re-imposition of the guarantee and further cost to the government.²²

Recommended Position for Bappenas: It's important to improve moral hazard in Indonesia's banking system and to reduce the government's exposure as regards further bailouts in the banking sector. Removing the guarantee is a useful instrument in this regard. But this step is risky and could trigger runs on smaller banks, especially if the deposit insurance scheme is not fully operational or if it lacks credibility.

Issue #8: "Savings" or "Narrow" Banks

This is an innovative suggestion that surfaced during the depth of the crisis to address governance issues of state bank lending. Under this approach, some state banks (the most obvious candidate being Bank Mandiri) would continue to accept deposits but would only invest in government bonds. This would maintain the government's presence in the banking sector; avoid risky lending to politically well-connected parties; and the narrow bank's deposits would effectively be guaranteed.²³ In principle, this option is worthy of consideration for banks with a wide branch network and a poor lending record.

In practice, this proposal is an extreme measure that is unlikely to amount to anything. Two years ago this proposal might have been implementable, but it's now fading as an issue. For example, Bank Mandiri has successfully restructured its balance sheet in a significant way; its lending is already expanding, *albeit* moderately; its medium-term business plan calls for a return to corporate lending; and it appears ready to launch an IPO within the next 6 months or so. The sale of other recap banks (like BCA,

²⁰ This is because the liabilities side of banks' balance sheets is covered by the government guarantee. On the assets side, 'systemically important' banks have more than 50% of their assets in government bonds, which are 'riskless' (see footnote 1).

²¹ Total premiums would amount to approximately Rp ½ trillion per year. This provides coverage for only one small- to mid-tier bank failure per year.

²² Some important supplementary issues should be noted. For example, ensuring the independence and professionalism of the management of the insurance fund, and introducing risk-based premiums. Also, it would be helpful to combine the deposit insurance institution with the new consolidated banking supervision institution because of the overlap in mandate of the two institutions.

²³ Ideally, this would be accompanied by a major downsizing, because loan-related staff and much of management would be redundant.

Niaga and Danamon) effectively precludes this option for them, and BRI has its own strong, core lending business. It's difficult to see how this option could now make a significant contribution to improving Indonesia's banking sector.

Recommended Position for Bappenas: This is not a bad idea, but it would entail a major shift in the established direction of the obvious, candidate banks. Consequently, the idea is likely to die a natural death, and it is not worth the struggle involved in resuscitation.

Issue #9: "Regional" Vs. "National" Banks

One popular direction for banking development in Indonesia concerns a shift from 'national' banks to 'regional' (or 'niche') banks. The idea may be to mirror the American system of regional banking versus the existing system of branch banking, which is common in many other countries, too. Under the regional approach commercial banks would be chartered to operate only in certain restricted areas, and their capital requirements might be appreciably below international standards (say 4% versus national banks of 8% and 'international' banks of 12%).

This initiative seems to be a product of decentralization and reflects dissatisfaction with national banks, which mobilize savings in the outlying regions and lend in the larger centers, especially Jakarta. Commercial bankers readily acknowledge that their remote regional offices accumulate more local savings that they disperse in local credits, essentially because the quality of local credit opportunities is low, notwithstanding strong demand.

There are four main issues regarding regional (or niche) banking. First, is a regional banking system more stable (that is, safer) and does it provide better service than a branch banking system? The evidence on this issue (mainly from developing countries, e.g., Canada versus the northern US) seems to be mixed, but tends to favor the branch banking system. The principle is simple—national banks have a broader deposit and lending base, which makes them less vulnerable to localized shocks. In this context, the idea of lower capital for regional banks is perverse—regional banks (which will have relatively narrow deposit and lending bases) tend to be relatively risky and therefore should have *larger* capital to act as a cushion against higher risk.

Second, is a regional banking system easier to supervise than a branch system? The answer is 'No', especially given institutional weaknesses in Bank Indonesia's regional offices and the envisaged shift to consolidated financial sector supervision. Also, if the development of regional banking were to lead to a proliferation of small, regional banks, it would add significantly to the already heavy burden of banking supervision.

Third, is financial intermediation improved by restricting banks to specific regions? The answer is almost certainly 'No' because regionalizing banks' lending operations restricts their options and makes them dependent upon localized economic conditions. For example, localized drought or regional political instability could

devastate regional banks, whereas national banks would be sufficiently diversified to survive.

Fourth (which is really the same as three), would regional banks spur regional development? Regions want local banks, because they want captive financing. Regional banks will probably do well in regions where economic growth is strong. By contrast, they will languish in slow-growth regions and fail in regions susceptible to economic cycles or shocks.

Finally, it should be noted that it would be relatively easy to evade the intentions of regionalized banking. First, on the side of the banks, they could always lend in the inter-bank market to banks in other regions. And second, borrowers from a high-interest-rate region could find ways to borrow from banks in low-interest-rate regions, using for instance proxies or 'fronts'.

Recommended Position for Bappenas: National banking looks preferable to regional banking, even if minimum required capital adequately reflects the risk of a narrow client base, and if there is adequate supervision. If better banking services are needed in the regions, wider branch networks would serve the same purpose and it's easier to supervise. Bank Indonesia could assist by accelerating its own internal process for approval of expanded branching (and ATM) networks

Issue #10: Sharia Banks

Sharia (Islamic) banking is expanding rapidly in Indonesia, by 40-50% annually. As of early 2002, there were 2 full Sharia banks and 4 Sharia business units with an office network of 49 branches, 11 sub-branches and 37 cash offices. In addition there are 81 Sharia BPRs (rural credit banks). For its part, Bank Indonesia is trumpeting the successes of this form of banking, and citing it as an example of improved financial infrastructure. Nonetheless, it continues to be a tiny component (less than 1%) of the total banking sector, and services are mostly concentrated in large cities, especially Jakarta.

At this stage, Sharia banking should be viewed as a form of niche banking in Indonesia. It is offering a legitimate service to a certain segment of Indonesian society, and it is probably attracting new funds into financial intermediation (as opposed to simply attracting existing savings out of the conventional banks). Furthermore, regulation appears to be comparable to other parts of the Indonesian banking system.

Recommended Position for Bappenas: This form of banking should be subject to regulatory oversight comparable to the rest of the banking system. If such supervision is in place, there is no obvious reason to be concerned about the development of this form of banking; its development should be encouraged by sensible economic means.

Issue #11: The ‘Landscape’ and ‘Blueprint’ Issues

Indonesia has come under criticism, especially from some international institutions, for no long-term vision for its financial sector. Without a long-term vision, short-term actions lack coherence and tend to be driven by the immediate needs of Indonesia’s IMF program.

In response to this criticism, consultants have tried to initiate some strategic thinking in this regard, and an officially appointed team in Bank Indonesia is carrying this particular ball. As of July 2002, the Landscape study (also known as a ‘Banking Architecture’ study) exists in draft form, but Bank Indonesia is most reluctant to release it because of political sensitivities, probably vis-à-vis the regions. As indicated by BI staff, the main, forward-looking issues covered by the Landscape Study are: i) structure of the future banking system; ii) ownership; iii) supervision and examination; iv) infrastructure; v) good governance; and vi) consumer protection. Of these, the first two (structure and ownership) are the most controversial. As of July 2002, no proposals had been finalized; indeed, there appear to be continuing disagreements, even on basic, guiding principles (e.g., safety versus competition in the banking system).

Concerning the ‘Blueprint’ issue, this is essentially an IMF-driven, training program for bank supervisors and commercial bankers (working through the newly-introduced Compliance Directors). It emphasizes a shift away from the old ‘compliance-based’ system of supervision towards BIS standards of ‘risk-based’ supervision. Within Bank Indonesia, there are two pillars for this Blueprint, namely training of supervisors and updated systems of supervision. Progress has advanced to the point where BI is ready to begin field trials at a few banks. The time schedule is driven by the IMF LOI, which requires implementation (of both the Blueprint and the results of the Landscape Study) by end-2002.

Recommended Position for Bappenas: Without a large push from the IMF, nothing substantive seems likely to arise from the Landscape study for some time. Nevertheless, it’s regrettable that Bank Indonesia has been unable, to date, to share their thinking as regards details of the banking landscape study. There needs to be some discussion (with the public and other government agencies, including Bappenas) of the issues in due course. For its part, the ‘Blueprint’ study seems to be an internal BI training matter.

Appendix I:

A Strategy for Bappenas' Role in the Financial Sector

Development of Indonesia's financial sector is vital for a return to strong sustained economic growth. Indeed, without advances in some key areas, there is a sizable risk that Indonesia could slip back into macro-economic instability. Consequently, it would be very useful if Bappenas could develop additional capacity in this area.

Unfortunately, topics in the financial sector are complicated, often involving narrow technical issues that require very specialized skills.²⁴ Historically, Bappenas staff do not have expertise in these areas, and the available numbers of staff fall well short of what would be needed to make a contribution beyond that of other, established institutions. In addition, Bappenas does not usually have a strong institutional voice in the forum where the key decisions are made.²⁵ Consequently, Bappenas will need to establish its credibility in this area before the other key institutions around town will pay much attention to its views.

With these considerations in mind, Bappenas will need to be selective in the issues that it wishes to address in the financial sector, and it needs to be modest as to the impact that it can have. Elements of a strategy and some specific recommendations are outlined below.

Suggested Strategic Objective

- Bappenas should have an adequate capacity to understand the most important issues in the financial sector; to follow policy developments in other key institutions; to be able to respond to queries from Bappenas' minister and management; and, ideally, to have a credible, independent view in critical areas.

Suggested Strategic Directions

Strategic Element #1: In selecting issues to be addressed, one useful approach would be to *concentrate on areas that potentially have a macro-economic impact*. At the current juncture, the obvious candidates are the banking sector and the bond market. Looking further ahead, this would include areas where the government has large contingent liabilities, like pension funds. By contrast, it would exclude considerations related to equity markets (the JSX and SSX).

Strategic Element #2: Begin with *understanding the current issues and policy initiatives*. There are so many technical and institutional details associated with these financial markets that a limited number of Bappenas staff cannot hope to be on top of them all. As

²⁴ It's notable that these skills are normally in high demand by the private sector.

²⁵ A notable exception is the FSPC, where Bappenas is currently represented. This is a key in setting out the strategy outlined above.

a starting point, a reasonable objective is to concentrate only on the broader issues, leaving all details to the appropriate policy-maker and regulator. Once good analysts have a deep understanding of the issues and the policies, they will naturally develop a capacity for independent policy assessment.

Strategic Element #3: Develop the capacity to respond to queries. This entails two sub-elements (in addition to the usual training and staff development issues). First, Bappenas staff need to maintain certain basic data on financial markets (see below) to follow on-going issues. And second, the staff should know where to look for additional data and advice for special queries.

Some Details

What Data? Best practice these days is a set of Bloomberg screens, which is standard equipment for private sector financial analysts. For Bappenas, this is not a serious option; the staff will need to be more diligent in seeking out the data, nurturing contacts and maintaining flows of information.

What Websites? There are some obvious websites that should be visited regularly for data updates, for instance, those of: Bank Indonesia; the Ministry of Finance; BPPN; and the JSX. There are other, less obvious choices worth mentioning, for example, those run by the major rating agencies (Moody's, S&P, and Fitch) and the news services (for instance, Bloomberg and Detik).

What Publications? The standard Bank Indonesia publications (or their website) are a staple in maintaining banking data. In addition, a great deal of the information mentioned above is readily available in newspapers, for example, bank's quarterly balance sheets, reports of rupiah and off-shore bond issuances; the rating of sovereign debt by the main rating agencies; and local bank ratings. The Asian Wall Street Journal, Bisnis Indonesia, Kontan and InfoBank are all very useful in this regard.

Private Sector Contacts. Despite the post-crisis exodus of foreign financial houses from Jakarta, there are still several firms with useful research capacity. Staff at these firms are very well informed in their own areas of expertise, and they are usually eager to talk about recent developments and the state of markets. Offshore, there are many companies in Singapore and Hong Kong that still keep an eye on Indonesia.

A word is in order in dealing with these private companies. Naturally, their representatives are all looking for insights themselves, and this raises issues of confidentiality of public policies. In my experience, the private sector economists are very well behaved and discrete. For example, if a discussion heads into sensitive areas, they will always accept limits as defined by the government representative.

To take advantage of these opportunities, Bappenas staff need to get more comfortable in this role; take the initiative; and make a sizable effort to establish the relationships. Opportunities are there, but Bappenas staff need to be pro-active in their follow-up.

Appendix II: A Primer on Bank Capital and Capital Adequacy

What is Capital?

In simplest terms, a business' capital (also known as 'owner's equity') is the owner's own cash contribution to his business. In a limited liability (PT) company, it is the maximum that the owner can lose if his business goes bad. Capital is a stock concept, which at any given point in time comprises the owner's original contribution to the company's operations plus accumulated retained earnings (that is, after-tax profits that have not been paid out in dividends).

In practice, there are many types of capital, and these are grouped as Tier I (highest quality); Tier II (supplementary capital); and Tier III (lowest quality). See 'Some Details' below.

Why Emphasize Capital?

Capital is very important for limiting risky behavior on the part of owners. The idea is simple—the more of their own money that owners contribute to a business (and therefore stand to lose if the business goes bankrupt), the more likely those owners will behave responsibly. Conversely, if owners contribute only a relatively small amount of their own money to the business (and therefore stand to lose little, if the business goes broke), they are more likely to run the business irresponsibly.

If, in addition, minimum capital is defined relative to total assets, capital serves as an automatic brake on the pace of a business' expansion. Once the minimum is reached, owners can only expand their business (i.e., increase company assets) by contributing proportionately more of their own money.

When a company's capital goes negative, it is bankrupt. Owners have nothing left to lose, so they become irresponsible; in particular, they normally undertake riskier and riskier initiatives in the hope that good luck will save them. Usually, good luck does not intervene, and the losses mount.

When *banks* go broke, deposits are the major liability, so ordinary people stand to lose their money. Alternatively, the state has to step in with large amounts of cash (or other interest-earning assets, like bonds), which passes the loss along to taxpayers or future generations. To avoid this problem, banks are normally subject to unusually strong regulatory oversight (also called 'banking supervision') and the regulators normally intervene and close a bank *before* capital becomes negative.

The Role of the BIS (Bank for International Settlements)

The Bank for International Settlements (based in Basel, Switzerland) has become the international authority for issues like capital adequacy. This was an outgrowth of the Basel Committee on Banking Supervision, established by the G-10 central banks in 1974 specifically to address issues of credit risk faced by banks and bank supervisors. It was originally intended for global banks, but it has been widely adopted by central banks for domestic banks as well.

The first result was the so-called Basel Accord of July 1988 (also known as ‘International Convergence of Capital Measurement and Capital Standards’), which formed the foundation for bank regulators worldwide to set capital requirements. It has been modified several times. The most recent version is called ‘The New Basel Accord’; and agreement on key issues was announced on 10 July 2002 (see BIS press release of the same date). The New Accord is to be finalized in late 2003 with implementation by participating countries by end-2006.

There are three main areas in the New Basel Accord: i) refined measures of minimum capital requirements; ii) banks’ internal review processes; and iii) effective use of disclosure and market discipline. Of these, i) is the most important. They are all very technical, and only a specialist can understand all the details.

A Few Details on the Definition of Capital.

Tier I Capital: generally, common equity, current year net profits, some preferred shares and ‘hybrids’ (which rank between common and preferred shares and usually carry no voting rights); LESS goodwill. The inclusion of prefs and hybrids is controversial, and ‘too much’ of them is considered bad. Goodwill is deducted because it’s open to abuse and it’s too difficult to measure accurately.

Tier II Capital: Includes many items such as: reserves arising from asset revaluations; general loan provisions (up to a ceiling); and certain types of preferred shares and (subordinated) debt (minimum original maturity of 5 years). There are often tax benefits and increased profitability associated with Tier II capital, and it can be used to avoid diluting existing ownership.

Tier III Capital: Term subordinated debt of minimum maturity of 2 years. Generally not important in Asia.

BIS standards on *composition* of Capital are:

- Tier 2 cannot exceed 50% of total capital;
- Hybrid Tier I cannot exceed 15% of total Tier I.

In Indonesia, there is very little hybrid Tier I, preferred shares and Tier II subordinated debt. One notable exception is Bank Mandiri, which is currently in the process of

borrowing subordinated debt for use as capital. Consequently and ironically, capital structures in Indonesian banks are quite ‘clean’.

How is CAR Calculated?

A bank’s Capital Adequacy Ratio is calculated by dividing capital (Tier I and/or total) by ‘risk-weighted’ assets rather than total assets. Risk-weighted assets are calculated by taking the assets’ nominal value from the bank’s balance sheet and multiplying them by a ‘risk-weight’ that has been assigned to that asset category. (See BIS weighting scheme). Countries refine the BIS scheme to their individual circumstances (see Bank Indonesia’s weighting scheme).

Problems, And Why 8%?

Despite widespread acceptance, this approach has some problems. Most notably, the risk weightings are quite arbitrary. For example, a loan to the best private company in the world would have a risk weighting of 100%. But a loan (in local currency) to the government of Brazil, Argentina or Indonesia would normally have a weighting of 0-20%. Also, banks (like BTN) that loan only for mortgages, can book twice as many loans for the same amount of capital as, say BRI’s Unit Desa program. In principle, mortgages are safer (because they are backed by collateral), but it can be very difficult to collect that collateral. Moreover, real estate markets tend to be very risky.

By way of another example, if certain banks, like BCA and Bank Mandiri, have large portfolios of government bonds (with a zero risk-weighting), they can have an extremely high CAR, but it will be unsustainably high as they start to shift into lending again.

The 8% minimum benchmark of the BIS is also arbitrary. But it has acquired the status of ‘international best practice’ and, these days, any bank aspiring to international status must respect this norm. Consequently, the 8% minimum has often become a goal in itself, including in Indonesia. This said, 8% is not a particularly demanding target. Many banks elsewhere in Asia are 10% and above; in Singapore (which is widely considered to be over-capitalized), the 5 major banks’ capital ranges from 15 to 24%. Bank Indonesia has been considering raising the local minimum CAR to 12%.

As noted earlier, one key value of the CAR that is *not* arbitrary is ‘zero’. When capital becomes negative, it means that the bank is bankrupt and it should be closed. Regulators in many countries favor closing a bank *before* the CAR goes negative. In any case, the CAR represents a key indicator for regulatory intervention in a bank. By way of simple example, when a bank’s CAR falls below the minimum, say 8%, the bank normally become subject to stricter supervision; if there are no prospects of an early turnaround, owners could be required to add more capital (preferably Tier I). If the CAR continues to deteriorate, and falls below some pre-determined level that is still above

Part I: The Banks

zero, normal regulatory practice is to close the bank, liquidate the assets and pay-off the liabilities in accordance with local regulatory process (such as deposit insurance, deposit guarantees or bankruptcy proceedings).

Appendix III: Bonds and Financial Engineering—Assessment of Some Options

It's tempting to look for imaginative ways to reduce the public cost of the 1997/98 banking crisis. This cost is burdensome on the budget and it angers many observers that the benefits are being reflected in enormously high capital adequacy ratios for several banks and in high profits for those same banks (see footnote 6 in the main text).

Several suggestions have been made for reducing this cost to government by unconventional means (conventional means are discussed in the main text; see *Issue #3*). For example, significantly reducing SBI rates (apparently, without any thought as to the possibility of rising inflation); restructuring BI's balance sheet; settling the BLBI issue; and the exchange of various assets for recap bonds held by various banks. These and various other possibilities are discussed below.

Settling the BLBI

In the course of the financial crisis, Bank Indonesia (as lender-of-last-resort) extended major amounts of liquidity financing (BLBI) to troubled banks. The great bulk was never repaid. As part of the IMF negotiations, agreement was reached on sharing this cost as between Bank Indonesia and the government. From Sept 1998 through May 1999, the government issued Bank Indonesia some Rp 220 trillion in bonds (promissory notes bearing real interest rates of 3% with maturities in 2017 and 2018), but has not paid any interest to date. As of June 2002, amounts outstanding, including accrued interest amounted to Rp 267 trillion.

To resolve this impasse, an IMF-appointed independent team visited Jakarta in May 2002. The team looked at Rp 144.5 trillion in bonds issued in January 1999; another Rp14.5 trillion advanced after January 1999; and accrued interest of Rp 14 trillion. After investigation, the team proposed a sophisticated solution. The advances (of Rp 144.5 and Rp 14.5 trillion) would be replaced by 'Capital Maintenance Notes (CMNs)' in the amount of Rp 159 trillion; the accrued interest of Rp 14 trillion would be written-off. These CMNs would have no fixed maturity date (i.e., perpetuities) and would pay no interest. Bank Indonesia's annual profits (that would normally be remitted to the MoF) would be used to redeem an equivalent amount of these notes. The MoF would only pay interest to BI in the unlikely event that BI's capital were to become seriously impaired.

This solution effectively provides BI with an asset that is worth very little, except in extraordinary circumstances. For its part, the MoF has to pay no interest on the bonds (except in extraordinary circumstances) and the bonds do not have to be redeemed; MoF does, however, lose the non-tax revenue that BI would normally remit each year.

This is elegant financial engineering, and its possible because of the unique status of central banks—they print their own liabilities (base money) and do not pay any interest on them. For normal commercial operations, the situation is quite different (see below).

Restructuring BI's Balance Sheet

Other solutions to settle the BLBI are possible. For example, the government currently holds large (non-interest bearing) deposits at Bank Indonesia,²⁶ of the order of Rp 100 trillion. These could have been used to write-off part of the BLBI; the government's net position at BI would be unchanged; total debt would decline significantly; and the size of Bank Indonesia's balance sheet would shrink, bringing it more in line with reality.

Other aspects of Bank Indonesia's balance sheet also need attention. For example, the central bank has large real estate holdings, and their valuation is unclear (indeed, its unclear why BI should have any large, on-going holdings of real estate). Similarly, Bank Indonesia is a major shareholder in Indover, a Dutch bank, and it is widely believed that these assets are endangered. Furthermore, Bank Indonesia's balance sheet contains an enormous (Rp 50 trillion), unexplained allowance for bad debts. It would be helpful if a panel of auditors from other central banks were to conduct a detailed, independent review of BI's balance sheet (including foreign assets) and propose steps to clean it up.

Zero Coupon Recap Bonds

One innovative solution to reduce the interest cost to the government of the recap bonds, is to replace the existing bonds with so-called 'zero-coupon bonds'.²⁷ Such bonds provide immediate relief from the burden of interest spending in the budget, but two other important issues immediately arise. First and most importantly, if recap bonds don't pay any interest, the recipient banks will not have the cash flow to pay interest on their deposits.

The second major issue concerns the pricing (that is, the terms of exchange) of the zero-coupon bonds versus the existing recap bonds. If the bonds are to pay zero interest (compared with market rates of about 17% and recap bonds of about 15%) and if the exchange for recap bonds is to be at a 'fair price', very large amounts of zero-coupon bonds would have to be issued in exchange for relatively small amounts of existing recap bonds. Viewed from this perspective, the issuance of zero-coupon bonds would simply buy the government some time, namely until these major amounts of the new bonds mature.

²⁶ It seems odd that the government is required to pay market rates of interest on its bonds held by BI, but does not receive any interest on its deposits at BI.

²⁷ As the name implies, zero-coupon bond do not pay any interest. But they are normally issued at a discount such that the yield to maturity reflects market interest rates.

In conclusion, zero-coupon bonds could be used to relieve debt-servicing pressures on the budget. However, the relief is only temporary, if the pricing is 'fair'. Also, this alternative can only be pursued to the point where it does not impede the ability of the recipient banks to pay interest on their deposits.

Asset for Recap Bond Swaps

Another imaginative suggestion to reduce the outstanding stock of recap bonds is to offer banks the opportunity to exchange their bonds for loans still held by IRBA (BPPN). It's not clear why such a barter arrangement (i.e., a swap) would be preferable to the existing system of open bidding for loans. Under a transparent, competitive system of bidding for IBRA's loans, the government should obtain the maximum possible cash, which it would then use to buy-back its bonds. If the government is adept in its purchases, it could probably buy back some of those bonds at a discount.

A variation on this theme is to swap bonds for shares in state banks. For example, Bank Mandiri could swap its recap bonds for equity in Bank BNI. Again, it's not clear why this is preferable to open competitive bidding for the shares of BNI, using the proceeds to buy back the bonds from Bank Mandiri.

One reason the government might prefer asset swaps over open bidding, is because it intends to use strong-arm techniques during the negotiations, for example, forcing Bank Mandiri to accept below-market prices for the equity in BNI. This would be convenient for the government. However, it would conflict with the objective of running the state banks in a more business-like fashion, including through privatization.

There are three legitimate reasons why the government might use asset swaps instead of open bidding. First, the administrative cost of the bidding may be too high. Second, there may be collusion among the bidders. And third, the government may have enough leverage in bilateral negotiations with banks (especially the wholly-owned state banks) to obtain a higher price than available under open bidding. On balance, none of these seems likely, and bilateral negotiations with banks could open the door to malfeasance in pricing.

Dividend Policy

One reasonably simple way to reduce state-owned banks' capital is through dividend policy. For example, the owner (i.e. government) could direct (wholly-owned) state banks to pay out all profits in dividends (i.e., make no additions to capital from retained earnings) until the banks' capital falls back much closer to international standards, say 12 to 15%.

Similarly, the owner could direct the (wholly-owned) state banks to pay a one-time, special dividend to government, in the form of cash or government bonds. The bank would book a one-time loss; capital would be reduced closer to the required minimum; and government debt would decline.

Such use of dividend policy could work for banks in which the government is the sole shareholder, but it is not advisable for banks that have been partially privatized. As mentioned, it would also conflict with the objective of running the state banks in a more business-like fashion,

Seignorage, Cost-Control, and Larger, Regular Dividends

The more fundamental, longer-term issue for government is how to obtain larger, regular dividend payments from the state banks and Bank Indonesia. It is a matter of great frustration to senior government officials that staff salaries and benefits at these banks are very generous and that those banks' office buildings are among the most lavish in Jakarta. Nonetheless, profit remittances to the shareholder (i.e. the government) are relatively low. Clearly, cost-control at all these institutions is an important issue in ensuring that the revenues from state banking in Indonesia accrue in larger part to the state (and not just the connected lenders, management and employees of the state banks).

For the central bank, there is a separate issue of the government capturing more of the seignorage accruing from Bank Indonesia's operations. This issue will increase in importance as the government shifts to Treasury Bills and the cost to BI of conducting monetary control reduces (because the outstanding stock of SBIs will decline). This issue should be on the table for discussion before the shift from SBIs to T-Bills begins.

Part II: Capital Markets

This Report is the second part of a two-part study of Indonesia's financial sector. It examines the outlook and key issues for Indonesia's capital markets, with special attention to the options facing Indonesian policy-makers. It is organized in three sections, the first of which briefly reviews the key features of Indonesia's capital markets at present (see immediately below). The second, Section B, looks ahead, at six key issues facing Indonesian policy-makers in bond markets; Section C does the same for stock markets. This report should be read in conjunction with "Part I: The Banks".

Section A: Key Characteristics of Indonesia's Capital Markets

At present,¹ Indonesia's capital markets mainly comprise rupiah bond and stock markets. Both are relatively small and simple operations by international standards, with the Jakarta Stock Exchange (JSX) somewhat more advanced than local bond markets. Some domestic companies also have access to international capital markets at present. There is also a tiny commodities exchange, the Jakarta Futures Exchange, which specializes in some agricultural products (coffee, rubber, pepper and palm oil). By type of fixed instrument, there are corporate and central government bonds; **Medium-Term Notes** (which are generally unlisted and unrated); and there is a modest Repo market (see Issue #3, below). There are no municipal bonds to date.

Regulation of Indonesia's capital markets is shared among three bodies.² Bapepam acts as a public securities commission,³ whereas the JSX is a private, self-regulatory body (currently considering de-mutualization). In short, Bapepam supervises and controls licensing; the JSX has its own regulations concerning listing, trading and disclosure. The Department of Trade & Industry supervises the Jakarta Futures Exchange.

Trading on the JSX is concentrated in a few of the 180 brokers. For example, roughly 90% of transactions are accounted for by 20% of brokers, and roughly half of the

¹ Prior to the economic crisis, there was a very active market in various forms of relatively short-term (mainly 1-2 years, but possibly as long as 5 years) promissory notes (e.g., commercial paper and **Floating Rate Notes**). The 1997 crisis plus portfolio restrictions on various fund managers (especially insurance companies) effectively killed this market.

² In a related area, listing and rating requirements are not viewed as overly burdensome. Indeed, Perfindo, the local ratings agency is seen as tough, but fair, and having successfully established its integrity and independence in its early years. Nonetheless, there may be prospects for simplifying process in these areas as concerns SMEs.

³ Bapepam has developed a Capital Market Blueprint for 2000-2004, but several targets have had to be redefined in the wake of the 1997/98 financial crisis.

brokers have been losing money since the crisis broke. It's also notable that brokers' minimum paid-up capital is relatively low (Rp 5 billion or roughly US\$1/2 million) and that there is no local distinction between 'dealers' and 'brokers'.

Following the 1997 crisis and the collapse of Asia Pulp and Paper in 2001,⁴ the rupiah bond market has slowly turned around. There have been several new issues to date in 2002, and the total for the year will likely amount to Rp 5 to 10 trillion; the upper end of that range would be a record year for new issues. Bonds issued by state-owned enterprises have been heavily over-subscribed (3 times, in the case of PT Telekom), with demand particularly strong among local insurance companies and pension funds. Tenure of bonds is typically 3-8 years, carrying rates of 17-19% (with Telekom at the lower end and private companies at the upper end). Allowing for maturing issues, the Rp bond market will likely expand by Rp 5 trillion or more during 2002, which would be large by historical standards.⁵

Some Indonesian corporates have returned to off-shore borrowing, *albeit* in a moderate way at high rates of interest (for example, 700 bp over US Treasuries).⁶ As of mid-2002, 'first rate' Indonesian names (e.g. Indofood and Bank Mandiri) could roughly borrow US\$100-150 million in international markets.

In another notable recent development, there have been a large number of positive rating actions for Asian sovereigns since late November 2001. The three major rating agencies (Moody's, S&P and Fitch) have taken a total of 19 rating actions, of which 13 were favorable. Korea and Malaysia have been the major beneficiaries, but even countries further down the credit curve (like Indonesia, Viet Nam and Pakistan) have benefited.⁷

Turning to stock markets, the Jakarta bourse (JSX) is small by international standards (see Chart 3). Its capitalization⁸ is the same order of magnitude as Wellington and Manila, but it is roughly half the size of Bangkok⁹ and Bombay and it is only a small fraction of other major countries in the region. Measured in relation to GDP, market capitalization is quite low, 62.2%, compared for example to the Philippines (119%) or

⁴ During the period 1998-2001, Indonesia accounted for a mere 1% of US\$ bonds issued by Asian countries, compared with 15% before the crisis of 1997.

⁵ The only comparable recent years are 1997 and 2000 when total outstandings increased by Rp 5.7 and 6.5 trillion, respectively. Most years have been flat or declining. As of early 2002, total outstandings were only about Rp 20 trillion, down from Rp 22 trillion at end-2000.

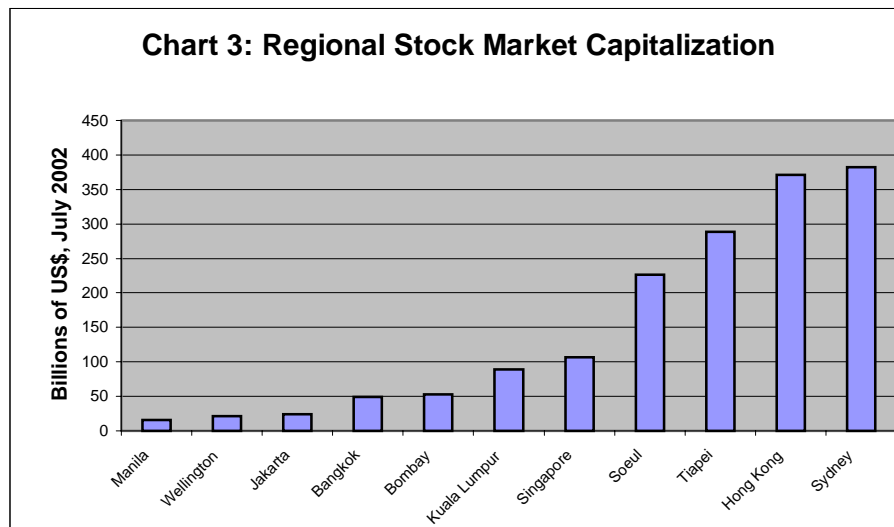
⁶ In another encouraging sign of improved confidence, the spread on Bank Indonesia's Yankee bond has been fairly stable in recent weeks at 350-400 basis points (versus initial pricing of 100 bp in 1996), which is comparable to the Philippines and Mexico benchmark spreads (400 and 325, respectively).

⁷ On 1 August 2002, Fitch upgraded Indonesia's long-term currency rating to B from B-, with the outlook remaining stable. On 24 April 2002, Moody's raised its outlook for Indonesia to 'Stable'. The day before, S&P had technically downgraded Indonesia to 'Selective Default' following the Paris Club Meetings; this had been widely anticipated and had little impact.

⁸ Measured by trading of shares, the ranking of Indonesia vis-à-vis other countries in the region is very similar to ranking by capitalization.

⁹ Prior to the crisis of 1997, the JSX's capitalization was larger than Bangkok's. In 2001 (a bad year for the JSX), average daily trading volumes on the JSX were 1/10th that on the Bangkok exchange.

Malaysia (478%). However, the number of listed companies is expanding rapidly (by almost 11% in 2001) and performance of the JSX index was about middle of the road for countries in the region in 2001.



Trading on the JSX is relatively simple (for example, there are no shorts and no futures),¹⁰ and it has an international reputation for technically smooth, professional processing of transactions. However, market players believe that there is still appreciable counter-party risk;¹¹ the settlement period is very long (4 days); many potential foreigners investors believe that the market is rife with insider trading and stock price manipulation;¹² complicated cross-ownership appears common, including with anonymous ‘fronts’; and, most importantly, the listed companies are beset with financial problems and weaknesses in corporate governance. For its part, the Surabaya Stock Exchange is tiny (less than one-tenth the size of the JSX), generally underdeveloped, lacking a role,¹³ and experiencing financial difficulties.

¹⁰ Margin trading is officially allowed, but no banks will lend for this purpose. Traders operating on margins must obtain their financing from non-bank sources.

¹¹ To be clear on terminology, ‘counterparty risk’ refers to the possibility that one side in a transaction will default after the other side is committed. ‘Settlement risk’ concerns the possibility of some systemic error, possibly only technical, causing a transaction to abort at a late stage.

¹² In an effort to control price manipulation and insider trading, Bapepam has placed limits on price increases, which trigger suspension in trading. But even without factors like insider trading, prices can be very volatile because trading in many stocks is extremely thin; even modest surges in demand can trigger large price increases.

¹³ Because virtually no stocks are traded on the SSX, that market has tried to specialize in bond and futures trading (the LQ-45 Futures Index, launched in August 2001). The latter (which is intended to be used for hedging) is still at an early stage of development, and the former is competing somewhat with the Jakarta Futures Exchange.

Part II: Capital Markets

Following the crisis of 1997, trading on the JSX declined in a major way, causing many foreign companies to close down their operations in Jakarta and pushing many local brokers into insolvency. Trading picked up significantly around end-2001 and the Jakarta composite index soared by almost 50% during the first several months of the year (by some 60% in US\$). Also, there appears to be greater interest on the part of foreign fund managers, who have been visiting Jakarta regularly in recent months. However, as mid-year approached, the market rally fizzled; by early August, the JSX had given up over half its gains since late 2001.

Section B: Forward-Looking Issues in Bond Markets

Issue #1: Increasing the Depth of the Bond Market

As noted, the Rp bond market may absorb Rp 5 trillion or more in 2002, which is a large amount by recent standards. By contrast, some Rp13.5 and Rp 52.4 trillion in government recap bonds fall due in 2003 and 2004, respectively, and this amount rises further to 74 trillion *per annum* by 2007 (see Part I, Issue #3).

On current indications,¹⁴ the government would like to re-finance as many maturing issues as possible by new issuances. In this regard, the main constraint is likely to be the bond market's absorptive capacity, including the extent to which private borrowings will be 'crowded out'. Clearly, a major expansion in the absorptive capacity of this market will be needed for the government to re-finance maturing issues in the next several years.

Funds are available for such a major expansion in bonds. By way of evidence in this regard, the Indonesian banking system currently holds about Rp 400 trillion in time deposits, the great bulk of which are at 1- and 3-month maturities and paying about 14% *per annum*. Consequently, deepening the Rp bond market largely depends upon attracting a significant proportion of these funds. For suggestions, see immediately below. There are already encouraging indications in this regard, for example, the heavily over-subscribed issues to date in 2002. Also, market participants report significant interest in bonds *outside* Jakarta, which is a market that is virtually untapped.

Recommended Position for Bappenas: At present, the rupiah bond market is too small to provide significant opportunities for re-financing the large amount of government bonds that mature, beginning in 2004. However, appreciable expansion is possible, on both current market indications and the amount of funds that are currently held in short-term bank deposits. Sectoral policies, outlined below, would be of substantial assistance in this regard.

Issue #2: Developing the Secondary Bond Market

If the government hopes to significantly improve the bond market at affordable rates of interest, it must deepen bond trading, that is, develop the secondary market for government bonds.¹⁵ Despite a burst in activity in trading of fixed-rate bonds in February through May (when interest rates were falling), trading in bonds has generally been

¹⁴ The Minister of Finance has repeatedly assured the public of the government's intention to meet these obligations. One legal impediment is the Domestic Borrowing Legislation which is still before Parliament, and which is unlikely to be passed before late 2002. However, on the basis of a mid-July agreement with Parliament, bonds maturing on 25 July (in the amount of 3.9 trillion) are to be financed by a new bond issuance.

¹⁵ Without a liquid secondary market, bond investors have to be paid interest rates that are high enough to compensate for the increased risk of holding a bond to maturity. As discussed under Issue #6, such rates are likely to be unaffordably high for most borrowers

modest to date.¹⁶ Typical monthly trading in government bonds (as reported by the SSX) is about Rp5 trillion, very roughly 1/5th that of corporate bonds. As of the end of Q1 2002, a total of roughly Rp 70 trillion in government bonds had been traded (about 16% of the total outstanding); at mid-year there was no significant trading activity.¹⁷

Recommended Position for Bappenas: Several steps are needed to encourage trading in government bonds. First, issues concerning debt sustainability and the implications for domestic debt need to be addressed (see Part I, Issue #3, “The Outlook for Recap Bonds”). Second, more transparency in pricing on the OTC market is needed (which concerns the role of the SSX; see below) and technical risks need to be reduced. Third, enabling legislation (The Sovereign Debt Law) for managing domestic debt needs to be passed by parliament. Fourth, resolution of some tax issues would help, as would development of markets in other supporting instruments (like Repos; see immediately below), and simplification of procedures for bond issuance by SMEs. Fifth, and on a parallel track to these other steps, continuing education of local fund managers will eventually be needed to fully alert them to the opportunities for bond trading (a buy-and-hold strategy seems to be common at present).

Issue #3: Nurturing the Repo Market

Indonesian lenders are constrained, *inter alia*, by perceptions of significant default risk, which could be eased appreciably by wider use of collateral. One possibility in this regard is development of a so-called Repo market. In this market, a borrower effectively sells some financial asset to a lender, with an agreement to buy it back (i.e., repurchase it) at a specific price and date in the future. The difference between the selling and buying price is the lender’s profit, and the financial asset provides the lender with security.

At present, there is an unregulated, over-the-counter market in Repos. For example, banks might enter into a Repo agreement using bonds or SBIs as collateral, or non-banks might use bonds. Such transactions are currently carried out on a case-by-case basis, but the market is very thin. Development of this market would boost the bond market, because bonds would be the most common collateral for a Repo agreement.¹⁸

One downside of developing this market concerns the potential for abuse. For example, companies might enter into Repos at financial year-end solely for the purpose of ‘window-dressing’ their financial statements at year-end. Indeed, market players assert that some companies are already doing this. Consequently, some forms of regulation will be needed, requiring companies to declare the size and maturity structure of their Repos, and BI is currently looking into this issue.¹⁹

¹⁶ Some bonds are surprisingly liquid. For instance, the FR0008 bond (which pays 16 ½% and matures in 2005) was traded 60 times in May 2002.

¹⁷ As SBI rates have declined closer to the rates offered on most fixed rate bonds, trading in fixed rate bonds has picked up only a little.

¹⁸ The great bulk of SBIs are of 1-month maturity. Consequently, they are used only for very short-term Repo arrangements.

¹⁹ Banks are already publishing their outstanding Repo positions in their financial reports, apparently in response to pressure from Bank Indonesia.

Recommended Position for Bappenas: Development of the Repo market is a useful step in the development of Indonesian financial markets, but it would also increase the demand for bonds. Some regulation will be necessary to avoid abuses and BI's efforts in this regard should be supported.

Issue #4: OTC Market Vs. the Surabaya Stock Exchange (SSX)

For some time, the Surabaya Stock Exchange has lacked a role relative to the JSX, and since the crisis of 1997 its status has been brought into question by continuing reports of financial difficulties. Consequently, there is a serious issue as to whether the SSX should be closed. As one option to closure, the SSX has sought to specialize in the bond market, leaving the vast bulk of stock trading to the JSX.

Despite SSX's efforts with regard to bonds,²⁰ a fairly active Over-The-Counter (OTC) market in bond trading has developed in Jakarta, effectively by-passing Surabaya.²¹ There are good reasons why investors prefer the OTC market. For example, the Rp bond market is still relatively thin, which leaves room for bilateral negotiations in pricing; well-defined 'bid-offer' pricing is still uncommon, which means that pricing is not fully transparent. In these circumstances, there are issues of confidentiality for some market players who do not want their competition to know about their pricing and volume of transactions. Also, in the OTC market, bonds are often traded in denominations of Rp 1 billion, which is a large amount for the SSX, raising the possibility of default risk in the SSX.

Recommended Position for Bappenas: Until the bond clearing system is improved to the point where settlement and counterparty risk are significantly reduced, the Surabaya bond market is likely to continue to languish. Either significant investment is needed to improve SSX electronic infrastructure or consideration should be given to closing SSX and developing the Jakarta OTC market.

Issue #5: Taxation Issues²²

Market players note the unequal treatment of withholding tax on interest income, as between different holders of bonds. Namely, banks, mutual funds and (some) pension funds are exempt from withholding tax whereas other bondholders (some of which are potentially very large, e.g., insurance companies) must pay 20%. Obviously, market players would prefer to have the exemption extended to interest on all bonds and T-bills.

²⁰ For example, almost all transactions on the SSX are now scriptless (ie, electronic) with the general exception being bonds in default.

²¹ Bonds traded in the OTC market should be reported to the SSX, for purposes of collecting withholding tax on interest.

²² Prior to the introduction of scriptless trading, it was possible to use the OTC market to avoid taxation. However, this no longer seems to be an issue. Consequently, the introduction of scriptless trading has reduced both fraud and paperwork. However, it has not eliminated settlement risk (see footnote 11).

This would promote development of the bond and T-bill markets somewhat. However, the tax gains would be largely offset by higher pricing (i.e., lower interest rates) and granting the exemption would open the door to more requests for similar treatment on other instruments.

Recommended Position for Bappenas: For reasons of economic efficiency, it would be helpful to level the tax playing field among different bondholders, but this should be done in a revenue-neutral fashion. For example, exemptions should be eliminated and the current tax rate (of 20%) could be lowered to offset the resulting revenue gains.

Issue #6: Pricing in a High-Risk Environment

Market participants continue to complain about the lack of a benchmark for ‘riskless’ bonds.²³ They argue that such a benchmark would make it easier to issue corporate bonds, which would deepen the local bond market. They also note that there is so much variability in the Fixed Rate recap bonds, that they aren’t very useful for this purpose.

This lack of a benchmark is a long-standing complaint among market players.²⁴ Indeed, it is so longstanding that it probably misses the real issue. Namely, that it’s very difficult to price risk in an environment as potentially volatile and opaque as Indonesia’s. Until this risk subsides appreciably in a sustained way, interest rates and exchange rate risk are likely to stay relatively high. Likewise, the development of futures, derivatives and options markets will continue to be severely hampered. In such circumstances, the cost to many borrowers of compensating lenders for perceived long-term risk is likely to be unaffordably high (e.g., US Treasuries plus 700 bps or more and 10-year rupiah rates approaching 20%).

Recommended Position for Bappenas: Until risk subsides significantly, long-term interest rates in Indonesia are likely to remain high. Sectoral policies can make a contribution to reducing this risk, and those policies (outlined elsewhere in this Report) should be actively pursued. But this will be a long-term challenge and rates may stay unaffordably high for many borrowers for some time.

²³ Others phrase their complaint differently, noting the absence of a yield curve at longer maturities.

²⁴ It’s not clear why the Telkom bond cannot serve as a benchmark, especially since its rating is above sovereign debt (see footnote #).

Section C: Forward-Looking Issues in Stock Markets

Development of Indonesia's stock markets is very important for several reasons. First, raising equity capital from the public is an important potential source of financing for companies, being an alternative to banks and bonds. Second, access to equity markets helps to ensure that corporate balance sheets do not become over-leveraged (that is too much debt relative to capital). Third, public listing dilutes conglomerate- and family-ownership. And fourth, equity markets increase foreign portfolio investment into Indonesia.

Issue #1: Lack of Demand

Clearly, low (domestic and international) confidence in Indonesia is a major factor behind weak demand for Indonesian stocks. Foreigner institutional investors are particularly important in this regard because they represent a major source of demand and generally greater analytic skills. At present, investors in the JSX tend to be very short-term, looking for under-priced opportunities, taking a modest profit and getting out quickly before market sentiment swings against them. Development of remote and on-line trading would probably be helpful in increasing demand. However, changing the nature of this market is one part of a much larger development problem, which realistically, will probably take a long time to address.

Recommended Position for Bappenas: Macroeconomic stability is a prerequisite for any significant progress in this area, supported by improvements to the broader legal, accounting and governance infrastructure. But sectoral policy can help to address these issues, as indicated below. In addition, more privatization of state-owned enterprises would help by increasing the number of medium- and large-cap stocks.

Issue #2: 'Disclosure-Based' Regulation

One very basic issue facing the JSX concerns adequacy of the current 'disclosure based' system of regulation, which is actually modeled on international best practice. Under the present system, once a company is cleared for listing, financial information is regularly made available to the public according to local accounting standards. Subsequently, the 'buyer-beware' principle appears to dominate, and de-listing of companies is rare.²⁵ As the economic crisis (and corporate scandals outside Indonesia) have made clear, there are limits to the applicability of this principle, particularly in a corporate culture as opaque as Indonesia's. Since the present system is based upon existing best practice, there is little prospect of change.

Recommended Position for Bappenas: More aggressive regulatory oversight would improve investor confidence in Indonesia's stock markets. Listing requirements could be tightened (because de-listing appears very difficult); the regulators need to be more pro-

²⁵ In principle, companies can be de-listed if they no longer meet listing requirements.

active in their enforcement of existing standards (see immediately below), beginning with a few high-profile de-listings of the worst offenders; and, ideally, a shift could be envisaged, from ‘disclosure-based’ to ‘merit-based’ regulation, in order to increase protection for investors.

Issue #3: Maintaining Regulatory Standards

A wide range of issues are covered by this topic, partly the result of fallout from the economic crisis. By way of a few examples, trading in a large number of companies is essentially inactive;²⁶ many listed companies probably wouldn’t meet international standards for listing;²⁷ and several brokers are technically broke,²⁸ making them a burden for the rest of the system. There are another series of related, on-going problems. For instance, a large number of listings are essentially micro-caps,²⁹ trading within the 4-day settlement period (locally referred to as ‘t+ trading’) does take place, despite regulations to the contrary; and brokers’ minimum capital requirements look too low.³⁰

Bapepam has the power to impose sanctions on parties that are proven to have violated regulations and capital market law. Sanctions range from written admonitions and fines to revocation of business licenses. Also, Bapepam can extend the cases from ‘investigation’ to ‘criminal investigations’. During 2001, Bapepam investigated 44 cases (including 4 carryovers from 2000). By way of innovative ideas for improving regulation, there seems to be significant scope for expanding the role of non-regulatory institutions (for example, NGOs and the media) to improve oversight.

Recommended Position for Bappenas: These are highly technical areas. Bappenas should support the development of professional management of the JSX, strong independent prudential supervision by Bapepam, and improvement in standards of corporate governance, including by the Indonesian Accounting Association.

²⁶ This is partly because some companies appear to be listed for strictly prestige purposes. In cases like these, IPOs (which must constitute at least 35% of all shares) tend to be closely held among designated investors, leaving only a very small proportion for trading on the market (known as the ‘free-float’). This could be overcome by increasing the minimum IPO from 35% to, say, 49%.

²⁷ Instead of de-listing these companies, the JSX has placed them in its ‘Development Board’, which separates them from companies in its ‘Mature Board’. If listing regulations had been strictly applied in the wake of the 1997/98 crisis, the great majority of companies would have been de-listed.

²⁸ There are reports in early July 2002 of one broker who could not deliver the cash to his client after he sold the client’s shares.

²⁹ These are often a nuisance to traders because they are not worth the market research to assess their value. Also, fund managers aren’t interested because the companies don’t meet minimum size requirements for their investment mandate.

³⁰ Minimum paid-up capital could be increased significantly, as currently appears to be under consideration. To preserve a role for small cap brokers, their status could be changed to that of sub-brokers.

Issue #4: Reducing Risk

As mentioned, the settlement period for stocks is currently 4 days (that is, $t+4$),³¹ which is a very long period that entails significant risk. There are excellent prospects of reducing this to $t+3$ later in 2002 and this would be a useful step. It would also be helpful to increase brokers' minimum paid up capital and to revoke the licenses of brokers who are technically bankrupt. Rules and/or enforcement need to be tightened concerning insider trading.

Recommended Position for Bappenas: These are highly technical areas. Bappenas should simply support the development of professional management of the JSX and strong independent prudential supervision by Bapepam.

Issue #5: Improving Information

Better information would assist trading on the JSX, as concerns, for example, the speed, quality and availability of company data. It would be most helpful if such information were available on the JSX website; foreign investors would be particularly interested if that information were available in English.

Recommended Position for Bappenas: Again, this is a highly technical area. Bappenas should simply support the development of professional management of the JSX and strong independent prudential supervision by Bapepam.

Issue #6: The Surabaya Stock Exchange

Whereas the SSX may have served a useful purpose in past decades, modern communications, including remote trading, have almost made it redundant. Also, efforts to encourage bond trading on the SSX have been notably unsuccessful to date and the prospect of using the SSX for futures trading looks very risky. Regional pride seems to be the main reason why the SSX has not been closed already.

In these circumstances, serious consideration should be given to closing the SSX before it loses still more money, or some major scandal erupts. If closure is not an acceptable option, the market might be turned into a platform for SMEs, or shrunk into an information center with remote trading into the JSX. To salvage some regional pride, the SSX could be merged with the JSX, re-naming the new agency as the Indonesia Stock Exchange.

Recommended Position for Bappenas: This problem is almost certainly not a systemic risk.

³¹ For bonds, it varies between $t+1$ and $t+10$, with the settlement period one factor influencing pricing.